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Dear Warren

**Auckland Council submission to the IPSASB Consultation Paper: Accounting for Revenue and Non-Exchange Expenses**

Thank you for the opportunity to comment on the consultation document of the International Public Sector Accounting Standards Board (IPSASB), *Accounting for Revenue and Non-Exchange Expenses*.

Auckland Council is Australasia's largest local government entity and is made up of the Council and six substantive council controlled organisations. We invest heavily in infrastructure and many of our decisions will have a fiscal impact on Auckland's future generations.

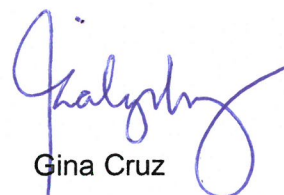
We have given our responses to the preliminary views of the IPSASB and the specific questions for the respondents as an attachment to this letter.

Once again, thank you for the opportunity to comment.

Yours sincerely



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General Manager Corporate Finance  
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**AUCKLAND COUNCIL**



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## Accounting for Revenue and Non-exchange Expenses Consultation Paper

### Attachment – Auckland Council’s Responses to Preliminary Views and Specific Matters for Comment

#### Preliminary View 1

The IPSASB considers that it is appropriate to replace IPSAS 9, *Revenue from Exchange Transactions*, and IPSAS 11, *Construction Contracts* with an IPSAS primarily based on IFRS 15, *Revenue from Contracts with Customers*. Such an IPSAS will address Category C transactions that:

- 1) Involve the delivery of promised goods or services to customer as defined in IFRS 15; and
- 2) Arise from a contract (or equivalent binding arrangement) with a customer which establishes performance obligations.

Do you agree with the IPSASB’s Preliminary View 1? If not, please give your reasons.

#### Auckland Council Response:

We support the view of the IPSASB that Category C transactions or transactions which involve enforceable agreements, with performance obligations to transfer goods or services to customers on commercial terms should be accounted for under an IPSAS based on IFRS 15 requirements.

We support public sector accounting standards convergence with the private sector’s IFRS as Auckland Council Group is a mixed group which means that the entities under the Group are adopting both PBE standards and IFRS. During consolidation, the Group identifies and adjusts differences resulting from being in a mixed group. Thus, for the Auckland Council Group, better convergence of PBE Standards with IFRS means fewer differences or adjustments during consolidation and reporting.

Auckland Council is also a bond issuer in the New Zealand Stock Exchange (NZX), Swiss and Singapore Stock Exchanges. Part of the Group’s requirements in the international stock exchanges is to identify differences between the PBE standards adopted by Auckland Council Group and IFRS. Thus, it is helpful for the readers or bondholders of Auckland Council Group’s annual report to see no major differences between PBE standards and IFRS.

#### Preliminary View 2

Because Category A revenue transactions do not contain any performance obligations or stipulations, the IPSASB considers that these transactions will need to be addressed in an updated IPSAS 23.

Do you agree with the IPSASB’s Preliminary View 2? If not, please give your reasons.

#### Auckland Council Response:

We support the preliminary view of the IPSAS to account for those transactions with no performance obligations or non-exchange transactions under an updated IPSAS 23.

#### Specific Matter for Comment 1

Please provide details of the issues that you have encountered in applying IPSAS 23, together with an indication of the additional guidance you believe is needed in an updated IPSAS 23 for:

- a) Social contributions; and/or
- b) Taxes with long collection periods.

If you believe that there are further areas where the IPSASB should consider providing additional guidance in an updated IPSAS 23, please identify these and provide details of the issues that you have encountered, together with an indication of the additional guidance you believe is needed.

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### Auckland Council Response:

The Group has no major difficulty in applying the requirements of PBE IPSAS 23 since it adopted the PBE Standards to its revenue streams. The one challenge for the Group is the general issue for non-exchange transactions in identifying if a stipulation is a “condition” or a “restriction”. The requirements of PBE IPSAS 23 have challenged the “old matching principle” practice as it requires the business to assess if the revenue should be recognised up front or as a liability and be recognised over time.

Accordingly, we encourage the IPSASB to explicitly address the “old matching principle” through disclosure by providing guidance. We are not supportive of allowing entities to defer recognition of revenue unless there is a clear “performance obligation” that is enforceable.

### **Preliminary View 3**

The IPSAB considers that Category B transactions should be accounted for using the Public Sector Performance Obligation Approach.

Do you agree with the IPSASB's Preliminary View 3? If not, please give your reasons.

### Auckland Council View:

Yes, we are supportive of this view. Please see our detailed response on revenue recognition in the next page.

### **Specific Matter for Comment 2**

The IPSASB has proposed to broaden the requirements in the IFRS 15 five-step approach to facilitate applying a performance obligation approach to Category B transactions for the public sector. These five steps are as follows:

- Step 1 – Identify the binding arrangement
- Step 2 – Identify the performance obligation
- Step 3 – Determine the consideration
- Step 4 – Allocate the consideration
- Step 5 – Recognise the revenue

Do you agree with the proposals on how each of the IFRS 15 five-steps could be broadened? If not, please explain your reasons.

### Auckland Council Response:

We agree with the proposals on how each of the IFRS 15 five-steps could be broadened especially the “identification of binding arrangement” which considers the public sector transactions and the concept of “performance obligation” which includes a three-party revenue transaction. Please see more details in our response on revenue recognition in the next page.

### **Specific Matter for Comment 3**

If the IPSASB were to implement Approach 1 and update IPSAS 23 for Category B transactions, which option do you favour for modifying IPSAS 23 for transactions with time requirements (but no other stipulations):

- a) Option (b) – Require enhanced display/disclosure;
- b) Option (c) – Classify time requirements as a condition;
- c) Option (d) – Classify transfers with time requirements as other obligations; or
- d) Option (e) – Recognise transfers with time requirements in net assets/equity and recycle through the statement of financial performance.

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Please explain your reasons.

### Auckland Council Response:

Although we consider that these approaches can be used for revenue recognition, we are not entirely supportive of these options. Please see our detailed response on revenue recognition in the next page.

### **Specific Matter for Comment 4**

Do you consider that the option that you have identified in SMC 3 should be used in combination with Approach 1 Option (a) – Provide additional guidance on making the exchange/non-exchange distinction?

- a) Yes
- b) No

Please explain your reasons.

### Auckland Council Response:

Yes, additional guidance on how to assess exchange/non-exchange should be added as it is a significant revenue recognition distinction.

### **Auckland Council Response on Category B Transactions' Revenue Recognition**

Since PBE Standards were adopted by public benefit entities in New Zealand, there have been challenges in assessing what is exchange or non-exchange and if a stipulation is a condition or a restriction. The possibility of convergence with IFRS 15 will add another consideration into the mix which is whether there are performance obligations or not. As an organisation, we will need to continue providing ongoing training to strengthen our finance professional's understanding of the current requirements plus the new requirements. Thus, we strongly encourage the IPSASB and the NZASB (for local requirements) to provide good guidance on the convergence of the old and new standards as part of issuing the new standard. We note that the revenue standard requirements for the public sector are not comparable with the requirements for the for-profit entities due to the non-exchange consideration. The for-profit entities are trying to simplify the revenue standards by consolidating several requirements for recognition into IFRS 15's recognition requirement. The challenge for the IPSASB is to converge with IFRS 15 and at the same time adopt a simplified approach of "how to recognise revenue streams in the public sector".

We would like to dissect some specific matters for comments by the IPSASB in relation to Category B transactions. Category B transactions include those transactions with enforceable agreements, with performance obligations or stipulations to use or consume resources in a particular way; and/or agreement requiring resources to be used over a specified period of time.

#### *Option (b) and (c) - Time requirements as a condition or classify as other obligations*

We are not supportive that time requirement should be consider as a condition or classified as other obligations. The time requirement alone is a common restriction in providing or receiving a grant and the common driver of the "old matching principle". We acknowledge that the "old matching principle" is no longer relevant under the new Conceptual Framework and thus, making time requirement as a consideration for not recognising the revenue up front means going back to the "old matching principle".

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### Auckland Council Response on Category B Transactions' Revenue Recognition (continued)

We believe that some public or non-for-profit entities receiving grants for multiple periods/years are having problems in preparing their annual report due to difficulty in presenting an imbalance financial performance wherein in the first period an entity reports a large surplus and in the subsequent periods losses are reported. To address this, these entities are already able to provide additional disclosures to explain to readers the multi-year grants under the current PBE Standards. Thus, we support allowing enhanced disclosure in the annual report, however, we acknowledge that merely the requiring additional disclosures option to account for Category B transactions may not meet all users' needs.

#### *Option (e) - Recycling in net assets/equity (other comprehensive revenue and expense) and through statement of financial performance*

In New Zealand, public benefit entities are able to use "Other Comprehensive Revenue and Expense". Auckland Council Group has items presented under Other Comprehensive Revenue and Expense such as revaluation gain on property, plant and equipment. We understand that the IPSASB has not introduced Other Comprehensive Revenue and Expense in the Conceptual Framework. We believe that the recycling method through Net Assets or Other Comprehensive Revenue and Expense maybe a neater and more organised approach rather than just merely providing additional disclosures in the annual report. However, we don't consider that the recycling addresses all the judgement considerations surrounding Category B transactions and adding such a consideration in the mix of required revenue recognition requirements does add complexities to the options for revenue recognition. The recycling may address some challenges in terms of timing restrictions.

#### *Public Sector Performance Obligation approach (PSPOA)*

Auckland Council supports the "Public Sector Performance Obligation" approach. The introduction of IFRS 15 in the for-profit entities aims to simplify the revenue recognition by focusing on "performance obligation". We believe that the term "performance obligation" can be adopted in the public sector, with some broadened characteristics as compared to the original IFRS 15.

At an overall level, we believe it is easier to assess a revenue transaction with specific recognition criteria in the public sector by focusing on requirements such as 1) *non-exchange or exchange* and 2) *whether there is a performance obligation or not*. We believe it is easier to assess if a revenue transaction has a performance obligation rather than considering if the stipulation in the agreement is a condition, as this adds complexity.

For example, in considering the revenue recognition of multi-period grants, an assessment should be made if the grant is an exchange or non-exchange. Normally grants are non-exchange as the grantor does not expect the same value in return. Next step for revenue recognition is assessing if there is a performance obligation which will be the driver of how the revenue is recognised either up front or over time. The challenge is in the definition of a performance obligation. We support how the IPSASB in the consultation paper defines a performance obligation. It should be **distinct performance** of either providing goods and/or services so that the revenue can be recognised as the performance obligation is satisfied. Distinct performance means "separately identifiable" in a binding arrangement between parties. For example a distinct performance is "a grant is received by a health clinic to provide vaccination to children in north Auckland" instead of "receiving a grant to fulfil the purpose of the clinic which includes vaccination of children".

Further to multi-year grant revenue which is normally provided by a grantor for the benefit of the public or third parties, we support the IPSASB consideration that in the public sector the revenue transaction is not just a two-party transaction. It could include a third party, for example, there could be a resource provider, resource recipient and beneficiaries. In this case, a performance obligation can be satisfied if the beneficiaries receive the distinct performance agreed between the resource provider and resource recipient.

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### Preliminary View 4

The IPSASB considers that accounting for capital grants should be explicitly addressed within IPSAS. Do you agree with the IPSASB's Preliminary View 4? If not, please give your reasons.

#### Auckland Council View:

Yes, we support IPSASB's view to explicitly address "capital grants" in the IPSAS.

### Specific Matter for Comment 5

- a) Has the IPSASB identified the main issues with capital grants?  
If you think that there are other issues with capital grants please identify them.
  
- b) Do you have any proposals for accounting for capital grants that the IPSASB should consider?  
Please explain your issues and proposals.

#### Auckland Council Response on Capital Grant:

Auckland Council and the entities under Auckland Council Group receive capital grants for the ongoing infrastructure requirements in Auckland. Capital grants are part of Auckland Council's revenue streams and one of the biggest revenue streams for individual council-controlled organisations. We do not experience significant issues with revenue recognition of capital grants. Under the current standard, the Group recognises capital grants based on the infrastructure completed during the period since the grantor agrees to provide funding for infrastructure spent during the period. Every period, the entity receiving the funding (cash in arrears) recognises capital grant revenue to the extent of the infrastructure spend during the period. Generally, there is no agreed specific amount to be funded as capital grants and there is no condition to return the funding if the project fails.

However, we noted the issues being raised in the consultation paper such as exchange/non-exchange assessment and the time requirement consideration for multi-year capital grant. We believe that the recognition of capital grants is one example where "a performance obligation" approach can be applied, thus, we support IPSASB's proposal to explicitly address capital grants in the standard and align the revenue requirements for recognition with the proposed changes. We note that when there is an identifiable performance obligation, we are supportive of the "Public Sector Performance Obligation" approach.

### Specific Matter for Comment 6

Do you consider that the IPSASB should:

- a) Retain the existing requirements for services in-kind, which permit, but do not require recognition of services in-kind; or
- b) Modify requirements to require services in-kind that meet the definition of an asset, to be recognised in the financial statements provided that they can be measured in a way that achieves the qualitative characteristics and takes account of the constraints on information; or
- c) An alternative approach.

Please explain your reasons. If you favour an alternative approach, please identify that approach and explain it.

#### Auckland Council Response:

We support IPSASB's option a above. We don't have material services in-kind received at Auckland Council Group, however, we are of the view that services in-kind should be assess carefully by the entity if there is value in recognition or the constraints under the Conceptual Framework are more prevalent (*materiality, cost-benefit, balance between relevance, timeliness, verifiability, etc*).

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Auckland Council performs accounting services for other related trusts and entities, such as the Independent Maori Statutory Board and other Reserve Boards. There are services Auckland Council provides in-kind to these entities such as IT services, accounting services, and human resources etc. We believe that quantifying these services (and then expensing them) doesn't add much value to these respective financial statements unless the amounts are material. Under the new standard, if the services they received are material to the readers, these can be disclosed in their financial statements and this option is welcomed by the preparers.

### **Preliminary View 5**

The IPSASB is of the view that non-exchange transactions related to universally accessible services and collective services impose no performance obligations on the resource recipient. These non-exchange transactions should therefore be accounted for under The Extended Obligating Event.

Do you agree with the IPSASB's Preliminary View 5? If not please give your reasons.

#### Auckland Council Response:

We believe that the recognition of expenses should be simplified and should not include significant judgement. In the public sector, there are plans (long-term plan, annual plan, etc) required by the legislation for local government to complete or appropriations for the national government.

In Auckland Council Group, the plans for collective services are commonly approved by the various committees or leaders and are announced to the public. These create expectations and can be considered or assessed as non-legally binding which in our view should not create a liability. However, these plans may change which driven by a change in leadership/political leaders or availability of funding.

The added consideration for non-legally binding obligations under "The Extended Obligating Event" approach creates a difficult judgement exercise for public sector entities. The public sector entity is only certain that these expenses are incurred when the entity entered into a legally binding agreement or the money has been disbursed. The universally accessible services and collective services with no performance obligations should just be simply recognised as incurred.

### **Preliminary View 6**

The IPSASB is of the view that, because there is no obligating event related to non-exchange transactions for universally accessible and collective services, resources applied for these types of non-exchange transactions should be expensed as services are delivered.

Do you agree with the IPSASB's Preliminary View 6? If not please give your reasons.

#### Auckland Council Response:

We agree with this view as this is consistent with how revenue is being recognised if there is no condition or performance obligation.

### **Preliminary View 7**

The IPSASB is of the view that where grants, contributions and other transfers contain either performance obligations or stipulations, they should be accounted for using the PSPOA which is the counterpart to the IPSASB's preferred approach for revenue.

Do you agree with the IPSASB's Preliminary View 7? If not, please give your reasons.

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### Auckland Council Response:

Those non-exchange expenses with performance obligations should also be accounted for consistently with how the revenue with the same performance obligations is accounted for. This is consistent with the PSPOA approach.

### **Preliminary View 8**

The Board considers that at initial recognition, non-contractual receivables should be measured at face value (legislated amount) of the transaction(s) with any amount expected to be uncollectible identified as an impairment.

Do you agree with the IPSASB's Preliminary View 8? If not please give your reasons.

### Auckland Council Response:

We are supportive of the preliminary view of the IPSASB on non-contractual receivables. The legislated amount or face (nominal) value, which often equals to fair value of the transaction demands accountability for management. We agree with the proponents of this option (as stated in the consultation paper) that non-contractual receivables such as receivables from rates for Auckland Council is of public interest and therefore the elected officials and the management should be accountable to report this information to the public, who are also readers of the annual report.

With this option, entities such as the Auckland Council Group are able to present the gross amount of the legislated rates and present any further reductions such as impairment. The preparers of the annual report can also present the movement from prior year of both the rates receivables and impairment which can improve the understanding of the readers/users of the annual report.

### **Preliminary View 9**

The IPSASB considers that subsequent measurement of non-contractual receivables should use the fair value approach.

Do you agree with the IPSASB's Preliminary View 9? If not, please give your reasons.

### Auckland Council Response:

We recognise the difficulty of the applying fair value approach to our ordinary receivables. The non-contractual receivables of the Auckland Council Group may include those arising from rates, fines, penalties, etc. Since these receivables are already considered non-contractual determining the market interest rate at each reporting date to calculate the fair value is a challenge. Identifying similar financial instruments with the same terms and risk profile is also a challenge as receivables from revenue transactions arising from legislative power is not common in the market.

We believe that it is easier to adopt the "cost approach" or lower of carrying value and recoverable amount. We support the consultation paper's assessed advantage of avoiding what are likely to be potentially arbitrary decision on market interest rates. On the other hand, the preparers are still able to use the "discounting of cash flows" and assessment of proper interest rates in determining the recoverable amount.

The cost approach doesn't add too much complexity in determining the subsequent measurement of simple receivables such as licenses, fines and penalties, etc.



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### Specific Matter for Comment 7

For subsequent measurement of non-contractual payables do you support:

- a) Cost of Fulfilment Approach;
- b) Amortised Cost Approach;
- c) Hybrid Approach; or
- d) IPSAS 19 requirements?

Please explain your reasons.

#### Auckland Council Response:

We believe that it would be easier to apply the Cost of Fulfilment approach as it requires a best estimate of the amount required to settle the liability, using the discounted cash flows approach where appropriate.

It is also consistent with the requirements of IPSAS 19 which is the best estimate of the expenditure required to settle the present obligation at reporting date which also considers the time value of money.